IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF IDAHO

IN RE	)	
	)	
MDR, INC., an Idaho Corporation, dba Windshield Doctor, dba Orchards Glass, dba Novus Windshield Repair,	)	**Case No. 98-30401**
	)	
	)	**MEMORANDUM OF DECISION**
Debtor.	)	**AND ORDER**
	)	
	)	
_____	)	

Kenneth L. Anderson, Lewiston, Idaho, for Debtor.

Darrel W. Aherin, AHERIN, RICE & ANEGON, Lewiston, Idaho for H.C. Hobson.

C. Barry Zimmerman, Trustee, Coeur d'Alene, Idaho.

Gary L. McClendon, Office of the U.S. Trustee, Boise, Idaho.

Attorney Kenneth L. Anderson ("Applicant") has asked the Court for an award of compensation under § 330(a) for services he rendered to the above

Debtor, primarily during the period that this case was a chapter 11. The U.S. Trustee and a creditor of the estate, H.C. Hobson, object. The matter came on for hearing pursuant to notice on July 20. The Applicant appeared, as did counsel for the U.S. Trustee.[1] The Court took the matter under advisement following the arguments of Applicant and the U.S. Trustee. This decision constitutes the Court's findings and conclusions on the application. Rule 7052, 9014.

BACKGROUND

On September 14, 1998 MDR, Inc. filed a voluntary petition under chapter 11 of the Code. Applicant was counsel for MDR at the commencement of the case. Applicant filed an application seeking approval of his employment as counsel for MDR as the Debtor in Possession on September 25, 1998. The Applicant filed a Rule 2014 statement in support of that application on the same date. Neither the statement nor the application disclosed that Applicant was also the attorney for Michael and Denise Rosen, the principals of MDR, or that the Rosens had also on September 14 filed

[1] No appearance was made on behalf of H.C. Hobson. That creditor's objection contested Applicant's entitlement to fees and the procedure and notice used. But, despite whatever irregularities may otherwise have been present in Applicant's notice, that notice clearly advised that the matter would be brought on for hearing on July 20.

through Applicant a chapter 13 petition, or that the Rosens held creditor claims against MDR.

The Court approved employment of counsel on November 9, 1998. Pursuant to L.B.R. 2014.1(c), the effective date of that approval was September 25, the date of the filing of the application.[2]

During the conduct of the chapter 11 case, it became apparent that the interests of the Rosens were in actual conflict with those of MDR. The Rosens were commercial landlords to MDR. Applicant represented MDR in the context of two November 13 motions in the chapter 11 case seeking to assume these real property leases, at the same time as he represented the Rosens.[3]

An amended application under § 327(a) and an amended Rule 2014 statement were filed on November 20, 1998. These pleadings disclosed only

---

[2] The application wasn't served as required by L.B.R. 2014.1 until almost a month later on October 23. Under *In re Olmstead*, 95 I.B.C.R. 210, 211 (Bankr. D.Idaho 1995), this could result in services being compensable only from the date of service, and not from the date of the application.

[3] These motions were amended approximately two weeks later, and proposed higher monthly lease payments to the Rosens. (The "Thain" lease went from $1,000/month in the November 13 motion to $2,500/month in the November 24 motion; the "Bryden" lease increased from $2,500/month in the November 13 motion to $3,500/month in the November 24 motion. There was no disclosure, through provision of the lease documents or otherwise, of the original lease payments.) Aside from the § 365 issues thus implicated, Applicant did not make it clear in these pleadings that he was representing the Rosens, or that they were attempting to gain this advantage as creditors of the MDR estate.

that the Rosens had filed a chapter 13 petition.[4] It was implicit, though not explicit, in these amendments that Applicant was the Rosens' attorney in this filing. No order was ever entered upon the amended application.

The case was converted to a chapter 7 liquidation on April 23, 1999. Applicant seeks award of compensation pursuant to § 330(a) for services rendered during the chapter 11.[5] Applicant seeks allowance of $3,678.00.

DISCUSSION

The U.S. Trustee raises several specific objections with regard to the application. For example, the U.S. Trustee notes that $516.00 in services were provided in the period between the filing of the petition and the filing of the initial application for approval of employment. The U.S. Trustee correctly notes that such

pre-application services have previously been held by this Court to be noncompensable under § 330(a). The U.S. Trustee also raises issues concerning whether allowance is proper for services rendered in connection with Applicant's seeking to withdraw as counsel for the Debtor, and regarding certain other charges. Addressing these various issues requires that the

---

[4] By this time, MDR's schedule G had already been filed disclosing that Rosens were creditors of the estate. This was not mentioned in the employment pleadings.

[5] By virtue of § 726(b), any compensation allowed Applicant would be subordinate in payment to administrative expenses incurred in the chapter 7.

Court first find, as a threshold matter, that there is a right to compensation. If no compensation is appropriate, the Court need not address whether or not discrete items in Applicant's submissions run afoul of the Code or precedent.

Section 327(a) contains two separate conditions which must be met by a proposed estate professional. First, the professional must himself be a disinterested person. Second, in order to be properly employed, counsel may not hold "or represent" an interest adverse to the estate. It is this latter provision which is at issue here.

The initial application and verified statement did not fully disclose the situation. The verified statement indicated only that Applicant "consulted with Mike and Denise Rosen, President and Secretary of the debtor corporation, respectively, prior to the filing hereof, and then prepared and filed the initial papers." MDR's petition for approval of employment of counsel, signed by Mr. Rosen on behalf of the corporation, stated in regard to Applicant's connections with the Debtor, creditors and parties in interest only that "the aforementioned attorney consulted with Mike and Denise Rosen, debtor's president and secretary, respectively, prior to the filing [of the MDR petition]." These pleadings did not disclose the fact of the Rosens' creditor claims, or that Applicant actually represented the Rosens personally (as

opposed to merely having consulted with them regarding the MDR situation).[6]

The Court's Order approving Applicant's employment was based upon these pleadings and representations. Under the circumstances, the fact that the Court entered such an Order approving employment cannot be used to insulate subsequent review as to whether the employment was proper or whether or not there existed a disqualifying factor -- a factor which not only eliminates the ability to be approved as a professional for a debtor in possession such as MDR but also potentially eliminates the ability to be compensated.[7]

The Applicant represented a chapter 11 debtor corporation, MDR, and at the same time in a chapter 13 case the corporation's sole shareholders, directors and officers. Whether or not there might be some situations in which such simultaneous representation would not give rise to a conflict of interest,

---

[6] As noted, the amended employment pleadings added little to the original disclosures other than noting that the Rosens had filed a chapter 13 case.

[7] It is true that § 327(c) does not in a chapter 11 case disqualify a person for employment solely because of such person's representation of a creditor unless there is an objection by another creditor or the U.S. Trustee, in which case the Court shall disapprove the employment if there is an actual conflict of interest. *See*, *In re Carr*, 98.3 I.B.C.R. 84 (Bankr. D.Idaho 1998) (such a situation requires an actual hearing on notice to address conflict). Of course, failure to disclose the fact of creditor representation eliminates or at least seriously reduces the possibility that any other creditor or the U.S. Trustee will raise an objection.

the present situation is not one of them. It is the same as that in *In re Bliss Valley Foods, Inc.*, 88 I.B.C.R. 281, 286 (Bankr. D.Idaho 1988), where this Court held that counsel could not be approved to represent a debtor in possession while at the same time representing equity security holders who were also lessors to the debtor.

The Rosens were creditors of the MDR estate [8], and Applicant was necessarily aware of that fact by virtue of MDR's Schedule G filed on October 27 and the lease assumption attempts. There was an actual, disqualifying conflict. *Id.*[9] And, as this Court held in *In re Dugger,* 99.1 I.B.C.R. 30 at 32 (Bankr.D. Idaho 1999), it need not weigh, measure or evaluate the degree of conflict or disinterestedness; its mere existence is enough. *See also, In re Leypoldt,* 95 I.B.C.R. 220, 222-25 (Bankr.D. Idaho 1995).[10]

---

[8] The Rosens were, in fact, creditors and equity security holders and insiders. *See* §§ 101(5)(B), 101(10)(A), 101(14), 101(16)(A), 101(17) and 101(31)(B).

[9] Also instructive on issues such as these are *In re Occidental Financial Group, Inc., 40 F.3d 1059 (9th Cir.1994); Rome v. Braunstein,* 19 F.3d 54 (1st Cir. 1994); *In re Bonneville Pacific Corp.,* 196 B.R. 868 (Bankr.D.Utah 1996), affd. in part, rev. in part, 220 B.R. 434 (D.Utah 1998); *In re Black Hills Greyhound Racing Assn.*, 154 B.R. 285 (Bankr. D.S.D. 1993); *In re American Printers & Lithographers, Inc.*, 148 B.R. 862 (Bankr. N.D.Ill. 1992). This is but the tip of an iceberg of relevant authority.

[10] That the Rosens "consented" to this situation or "waived" the conflict for themselves and MDR is not a cure. *See, e.g., American Printers,* 148 B.R. at 867.

The ramifications of a disqualifying conflict are serious. Section 328(c) provides:

> (c) Except as provided in section 327(c), 327(e), or 1107(b) of this title, the court may deny allowance of compensation for services and reimbursement of expenses of a professional person employed under section 327 or 1103 of this title if, at any time during such professional person's employment under section 327 or 1103 of this title, such professional person is not a disinterested person, or represents or holds an interest adverse to the interest of the estate with respect to the matter on which such professional person is employed. (Emphasis supplied.)

Strict enforcement of the ethical rules placed on estate professionals is required in order to protect the integrity of the bankruptcy system. *Bliss Valley*, 88 I.B.C.R. at 287; 89 I.B.C.R. 4, 5-6 (Bankr. D.Idaho 1989). While denial of compensation under § 328(c) is permissive rather than mandatory, the Court concludes, under all the circumstances, including the inadequate disclosures and patent nature of the actual conflict, that such a result is appropriate here. *Accord, In re Prince*, 40 F.3d 356 (11th Cir. 1994).[11]

For the foregoing reasons no compensation will be allowed for services rendered by Applicant in the chapter 11 case. This conclusion eliminates the need to address the other objections raised by the U.S. Trustee as to specific components of the application. Additionally, this conclusion leads to the result that the $2,500.00 which Applicant held as a retainer to secure payment of

[11] The lack of full and complete Rule 2014 disclosure is itself sufficient basis for denying all compensation. *In re Park-Helena*, 63 F.3d 877, 880-2 (9th Cir. 1995).

any fees and costs which might be allowed by the Court under § 330 is no longer available for that purpose. Applicant will therefore be required to turnover such funds to the chapter 7 Trustee for administration.

ORDER

Based upon the foregoing, the application for approval of compensation is DENIED. Applicant is ordered to turnover to the chapter 7 Trustee the $2,500.00 paid by MDR to Applicant as a retainer and held by him in his trust account.

Dated this 3rd day of August, 1999.

_____
TERRY L. MYERS
UNITED STATES BANKRUPTCY JUDGE